

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 97-19**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether, under the facts presented, the Taxpayer has the right to apportion for Tennessee franchise, excise taxes and, if so, how it will compute its franchise, excise tax apportionment formula.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

The Taxpayer is a financial institution with headquarters in Tennessee and is wholly owned by [COMPANY A]. The Taxpayer purchases from Company A, without recourse, accounts receivable from customers who are located in states other than Tennessee. Such accounts receivable are generated from sale of goods by Company A and purchases of the accounts will take place every ten days or on a similar periodic basis. Company A does not require collateral to secure its accounts receivable and does not retain a security interest in the products it sells.

The Taxpayer will purchase the receivables at their market value and will bear the risks and rewards of their ownership and be responsible for their administration, servicing, collection and maintenance. The Taxpayer may also be engaged to provide credit approval services to Company A and to service accounts receivable generated and held by Company A prior to their purchase.

The income that the Taxpayer receives from its factoring business will be classified as ordinary income on its federal income tax return and will generate more than fifty percent of its gross income.

The Taxpayer also makes unsecured commercial loans to customers throughout the United States. Proceeds from loans will be applied in states other than Tennessee.

After research of other state's statutes, the Taxpayer has determined that it will be filing an income tax return in at least one state besides Tennessee.

QUESTIONS PRESENTED

1. Does the Taxpayer have the right to apportion for Tennessee franchise, excise tax purposes?
2. If the answer to question 1 above is "yes", how will the Taxpayer compute its franchise, excise tax apportionment formula?

RULINGS

1. Yes.
2. The Taxpayer will use a single factor gross receipts apportionment formula. All interest income and other receipts from accounts receivable purchased from Company A, unsecured commercial loans made, and income from credit approval services will be included in the denominator of the Taxpayer's apportionment formula.

Interest income and other receipts from such accounts receivable purchased will be included in the numerator of the Taxpayer's apportionment formula to the extent that the

property sold and generating each account receivable was delivered or shipped by Company A to a purchaser or recipient located in Tennessee.

Interest income and other receipts from unsecured commercial loans will not be included in the Taxpayer's apportionment formula numerator because none of the proceeds of such loans are applied in Tennessee.

Receipts from credit approval services and the servicing of accounts receivable owned by Company A will be included in the Taxpayer's apportionment formula numerator if the greater proportion of the earnings producing activity for each separate item of income is performed in Tennessee based on costs of performance.

ANALYSIS

1. THE TAXPAYER HAS THE RIGHT TO APPORTION TENNESSEE FRANCHISE AND EXCISE TAXES

T.C.A. § 67-4-809 makes the following provisions concerning a corporation's right to apportion Tennessee excise taxes:

- (a) Any taxpayer having earnings from business activity which are taxable both within and without this state shall allocate and apportion its net earnings as provided in this part.
- (b) For purposes of allocation and apportionment of earnings under this part, a taxpayer is taxable in another state if:
 - (1) In that state it is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or
 - (2) That state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

T.C.A. § 67-4-909 states as follows with regard to a corporation's right to apportion Tennessee franchise taxes:

In the case of corporations doing business in Tennessee and elsewhere, the measure of the tax as hereinabove set forth shall be apportioned to Tennessee for the purpose of taxation in the manner set forth in this part.

The following statements are made in Tenn. Comp. R. and Regs. 1320-6-1-.25(1) and (3) concerning the jurisdiction of other states to subject a taxpayer to a net income tax:

- (1) . . . A taxpayer is taxable within another state if it meets either of two tests:
 - (a) If by reason of a business activity in another state the taxpayer is subject to one of the types of taxes specified in Section 67-4-809(b)(1) namely: a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing

business, or a corporate stock tax; or (b) If by reason of such business activity another state has jurisdiction to subject the taxpayer to a income tax, regardless or whether or not the state tax imposes such a tax on the taxpayer. . . .

(3) The second test, that in Section 67-4-809(b)(2), applies if the taxpayer's business activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the Constitution and statutes of the United States. . . .

Under Tennessee law and franchise, excise tax rules and regulations, a corporation has the right to apportion for Tennessee excise tax purposes if another state subjects it to an income tax. After research of other state statutes, the Taxpayer has determined that it will be required to file an income tax return with at least one other state. Assuming the Taxpayer's interpretation of the requirements of the tax laws of other states is correct, the Taxpayer has the right to apportion for excise tax purposes due to the fact that it will be required to pay an income tax in another state.

However, T.C.A. § 67-4-809(b)(2) states that a corporation can apportion its Tennessee excise tax even if it is not required to pay an income tax to another state if another state has jurisdiction to subject the corporation to a net income tax regardless of whether, in fact, the state actually imposes such a tax. Under Rule 1320-6-1-.25 (3), another state has jurisdiction to impose a net income tax if the corporation's business activity in another state is sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States.

T.C.A. § 67-4-806(d) sets forth certain activities which, if conducted in Tennessee, will subject a financial institution to Tennessee excise taxes. Among such activities are those recited by T.C.A. § 67-4-806(d)(2)(D), (E) and (F) as follows:

- (D) Regularly solicits business from potential customers in this state;
- (E) Regularly performs services outside this state which are consumed in this state;
- (F) Regularly engages in transactions with customers in this state that involve intangible property, including loans, and result in receipts flowing to the taxpayer from within this state;

Under the facts presented, the Taxpayer will conduct some or all of the above activities in states other than Tennessee. If a financial institution were conducting such activities in Tennessee, our statutes would subject it to Tennessee excise taxes. We believe that our financial institution franchise, excise tax statutes are valid under the Constitution and statutes of the United States and that Tennessee, as well as any other state who wishes to do so, has jurisdiction to impose an excise tax based on income, or an income tax, on a financial institution conducting such activities within its borders.

Accordingly, the Taxpayer meets the excise tax right to apportion test of T.C.A. § 67-4-809(b)(2) in that a state other than Tennessee has jurisdiction to subject it to a net income tax regardless of whether, in fact, the state does so.

With regard to activities that would subject a financial institution to Tennessee franchise taxes, T.C.A. § 67-4-903(f)(2)(D), (E) and (F) is identical to T.C.A. § 67-4-806(d)(2)(D), (E) and (F) and the Taxpayer will conduct some or all of the activities recited in states other than Tennessee. T.C.A. § 67-4-909 states that corporations doing business in Tennessee and elsewhere shall apportion the measure of the franchise tax.

If a financial institution located in another state were to conduct any of the activities recited in T.C.A. § 67-4-903(f)(2)(D), (E) and (F) in Tennessee, it would be subject to our franchise tax. The Taxpayer will be located in Tennessee but will conduct some or all of the activities recited in T.C.A. § 67-4-903(f)(2)(D), (E) and (F) in various other states.

For purposes of nexus and apportionment, Tennessee will apply the same “doing business” standard for activities conducted outside Tennessee that it recognizes for activities conducted within Tennessee. If a corporation’s business activities in another state, had they been conducted in Tennessee, create franchise, excise tax nexus here, the corporation will be allowed to apportion.

The Taxpayer is “doing business in Tennessee and elsewhere” within the meaning of T.C.A. § 67-4-909 so as to be entitled to apportion for Tennessee franchise tax purposes.

2. **APPORTIONMENT PROVISIONS APPLICABLE TO THE TAXPAYER**

The Taxpayer will have interest income and other receipts from assets in the form of accounts receivable it has purchased from Company A. Company A does not require collateral to secure its accounts receivable and does not retain a security interest in the products it sells, so the accounts receivable purchased by the Taxpayer are unsecured. T.C.A. § 67-4-815(a) and (d)(2)(A) make the following provisions concerning excise tax apportionment by a financial institution not filing a combined franchise, excise tax return and having interest income and other receipts from assets in the nature of installment sales contracts that deal with tangible personal property. T.C.A. § 67-4-919(a) and (d)(2)(A) make similar provisions for franchise tax apportionment purposes.

(a) A financial institution which is not filing a combined return and which has earnings from business activity both within and without this state shall apportion its business earnings by multiplying such earnings by the quotient of the institution's total receipts attributable to the transaction of business in Tennessee, as determined under subsection (d), divided by the institution's total receipts attributable to transacting business in all taxing jurisdictions, as determined under subsection (d).

(d)(2)(A) Interest income and other receipts from assets in the nature of loans or installment sales contracts that are primarily secured by or deal with real or tangible personal property shall be attributed to Tennessee if the security or sale property is located in Tennessee. If any part of the sale property or property standing as security for the payment of the debt is located part within and part without the state, only such proportion of the interest income or other receipts shall be attributed to Tennessee as the value of the property within the state bears to the whole property.

The Taxpayer will use a single factor gross receipts apportionment formula to apportion net earnings for excise tax purposes and outstanding stock, surplus and undivided profits for franchise tax purposes. All interest income and other receipts from the accounts receivable purchased by the Taxpayer from Company A will be included in the denominator of the Taxpayer's apportionment formula. The accounts receivable purchased by the Taxpayer are unsecured. Thus, the interest income and other receipts from the accounts receivable purchased by the Taxpayer will not be secured by, but will "deal with" tangible personal property. In accordance with T.C.A. §§ 67-4-815(d)(2)(A) and 67-4-919(d)(2)(A), the interest income and other receipts from the accounts receivable purchased by the Taxpayer from Company A will be included in the numerator of the Taxpayer's franchise and excise tax apportionment formula to the extent that the property sold and generating each account receivable was delivered or shipped by Company A to a purchaser or recipient located in Tennessee.

T.C.A. §§ 67-4-815(d)(4) and 67-4-919(d)(4), set forth in pertinent part below, make the following provisions concerning apportionment of interest income and other receipts from unsecured commercial loans.

Interest income and other receipts from commercial loans and installment obligations not secured by real or tangible personal property shall be attributed to Tennessee if the proceeds of the loan are to be applied in Tennessee.

The Taxpayer states that none of the proceeds from its unsecured commercial loans will be applied in Tennessee. Therefore, although such receipts are included in the denominator of the Taxpayer's franchise, excise tax apportionment formula, none are included in the numerator.

T.C.A. § 67-4-815(d)(8) makes the following provisions concerning excise tax apportionment of receipts from the performance of services by financial institutions. T.C.A. § 67-4-919(d)(8) makes the same provisions for franchise tax purposes and references T.C.A. § 67-4-910(i)

Receipts from the performance of fiduciary and other services shall be attributed in accordance with § 67-4-811(i).

T.C.A. §§ 67-4-811(i) states as follows for excise tax purposes and 67-4-910(i) makes similar provisions for franchise tax purposes.

Sales, other than sales of tangible personal property, are in this state if the earnings producing activity is performed:

- (1) In this State; or
- (2) Both in and outside this state and the greater proportion of the earnings-producing activity is performed in this state than in any other state, based on costs of performance.

Tenn. Comp. R. & Regs. 1320-6-1-.34(2) and (3), pertinent parts of which are set forth below, define the terms “earnings producing activity” and “costs of performance” as follows.

(2) The term “earnings producing activity” applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, the earnings producing activity includes but is not limited to the following:

(a) The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.

(3) The term “costs of performance” means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer.

If all, or the greater proportion, of the earnings producing activity for each separate item of income generated by the Taxpayer’s credit approval services for Company A is performed in Tennessee, the receipts so generated will be included in both the denominator and numerator of the Taxpayer’s franchise, excise tax apportionment formula. Likewise, if all, or the greater proportion, of the earnings producing activity for each separate item of income generated by the servicing of accounts receivable held by Company A is performed in Tennessee, the receipts so generated will be included in both the denominator and numerator of the Taxpayer’s apportionment formula. If all, or the greater proportion, of the earnings producing activity for each separate item of income from credit approval services, or each separate item of income from servicing accounts receivable, is performed outside Tennessee, the receipts generated from each activity will be included in the denominator but not the numerator of the apportionment formula.

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APPROVED:

Ruth E. Johnson, Commissioner

DATE: 6-5-97